

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0498
Sales and Use Tax
For Tax Years 2003-05**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales and Use Tax—Mold Release Spray

Authority: IC § 6-2.5-3-2; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; 45 IAC 2.2-5-12

Taxpayer protests the assessment of use tax on the mold release spray.

II. Sales and Use Tax—Silver Frames

Authority: IC § 6-2.5-3-2; IC § 6-8.1-5-1

Taxpayer protests the assessment of use tax on the silver frames.

III. Tax Administration—Negligence Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a manufacturer of industrial rubber products in Indiana. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax and assessed a negligence penalty for the tax years 2003, 2004, and 2005. The Department found that Taxpayer had purchased a variety of supplies on which the Indiana sales tax was not paid at the time of purchase nor was use tax remitted to the Department. Taxpayer protests the imposition of tax and penalty on cans of mold release spray and silver frames. Taxpayer failed to attend the hearing. Therefore, the Department wrote and issued a Letter of Findings based on the materials in the file.

I. Sales and Use Tax—Mold Release Spray

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC § 6-8.1-5-1(b).

The Department found that use tax was due on mold release spray that Taxpayer had purchased without paying sales tax on it. Indiana imposes “an excise tax, known as the use tax,” on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a).

Taxpayer maintains that the mold release spray is property consumed in the direct production of manufacturing tangible personal property and is exempt from use tax under the “direct consumption manufacturing exemption” as defined in IC § 6-2.5-5-1.

The “direct consumption exemption” to the use tax is provided, in relevant part, in IC § 6-2.5-5-1(b), as follows:

(b) Transactions involving personal property are exempt from the state [use] tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person’s business of manufacturing, processing, refining, [or] repairing. . . .

Property obtained for “direct consumption as a material to be consumed in direct production” is further defined in 45 IAC 2.2-5-12(c) as “materials [that] are directly used in the production process” and have “an immediate effect on the article being produced.” Property has “an immediate effect” when it becomes “an essential and integral part of the integrated process which produces tangible personal property.” 45 IAC 2.2-5-12(c).

Accordingly, property purchased for use or consumption in the direct production of a manufactured good is subject to use tax unless the property used has an immediate effect on and is essential to the production of the marketable good.

Taxpayer has provided sufficient information to establish that the mold release spray is property obtained for consumption in the direct production in manufacturing tangible personal property that qualifies for the consumption exemption. The mold release spray is “directly used or consumed” in the manufacturing of the rubber products. It is “essential” to and plays an “integral part” in the manufacturing of the rubber products. Without the mold release spray, the rubber could not be removed from the molds in one smooth piece. Thus, the rubber would come out in pieces or with flaws making it an unmarketable product. The use of the mold release spray can be compared to a baker’s use of butter or grease to ensure a cake will come out in one piece. Therefore, since the mold release spray is consumed in the direct production of property and plays an “essential and “integral part” in the manufacturing process, it is exempt from use tax under the direct consumption exemption.

FINDING

Taxpayer's protest is sustained.

II. Sales and Use Tax—Silver Frames

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC § 6-8.1-5-1(b).

The Department found that use tax was due on silver frames that Taxpayer had purchased without paying sales tax on them. As stated previously, Indiana imposes use tax on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. An exemption from the use tax is granted for transactions where the sales tax was paid pursuant to IC § 6-2.5-3-4.

Taxpayer asserts that sales tax was paid on the silver frames at the time of purchase. However, when Taxpayer was asked to provide the purchase receipt or other documentation showing that the tax had definitely been paid, Taxpayer could not produce it. As a result, Taxpayer has failed to meet its burden.

FINDING

Taxpayer's protest is denied.

III. Tax Administration—Negligence Penalty

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides, "if a person. . . incurs, upon examination by the department, a deficiency that is due to negligence . . . the person is subject to a penalty."

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC § 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). While Taxpayer has established that it does not owe some of the proposed assessments discussed in Issue I, Taxpayer has not affirmatively established that its failure to pay the remaining deficiencies was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest to the imposition of the penalty is denied.

AB/WL//DK-June 7, 2007